No. 84101-2

Court of Appeals No. 38247-4-II

SUPREME COURT OF THE STATE OF WASHINGTON

WASHINGTON IMAGING SERVICES, LLC,

Respondent,

vs.

WASHINGTON STATE DEPARTMENT OF REVENUE,

Petitioner,

Amicus Curiae Memorandum of City of Seattle In Support of Petition to Review

---

PETER S. HOLMES
Seattle City Attorney

Kent C. Meyer, WSBA #17245
Assistant City Attorney
Attorneys for Amicus Curiae
City of Seattle

Seattle City Attorney's Office
600 – 4th Avenue, 4th Floor
P.O. Box 94769
Seattle, Washington 98124-4769
(206) 684-8200

TABLE OF CONTENTS

Page(s)

I. INTRODUCTION 1

II. IDENTIFICATION AND INTEREST OF AMICUS CURIAE 1

III. ISSUES ADDRESSED BY AMICUS CURIAE 2

IV. ARGUMENT 2

A. The Decision Below Involves An Issue of Substantial Public Interest That Should Be Determined By The Supreme Court Under RAP 13.4(b)(4). 2

B. The Supreme Court Should Accept Review Under RAP 13.4(b)(1) Because The Decision Below Conflicts With Decisions Of The Supreme Court. 4

V. CONCLUSION 7

TABLE OF AUTHORITIES

CASES

Christensen, O'Connor, Garrison & Havelka v. Department of Revenue, 97 Wash.2d 764, 649 P.2d 839 (1982) 4

City of Tacoma v. William Rogers Co., 148 Wn.2d 169, 60 P.3d 79 (2002) 5, 6

Washington Imaging Services, LLC v. Washington State Department of Revenue, 153 Wn. App. 281, 222 P.3d 801 (2009) 1, 2, 3, 6

STATUTES

RCW 35.102.030 1

RCW 35.102.040 1

ORDINANCES

SMC 5.30.035(D) 3

SMC 5.45.040C 4

SMC 5.45.050 1

RULES

RAP 13.4(b)(1) 4

RAP 13.4(b)(4) 2, 4

REGULATIONS

WAC 458-20-111 4

I. INTRODUCTION

The City of Seattle submits this brief in support of the Department of Revenue's petition for review of *Washington Imaging Services, LLC v. Washington State Department of Revenue*, 153 Wn. App. 281, 222 P.3d 801 (2009).

II. IDENTIFICATION AND INTEREST OF AMICUS CURIAE

The City of Seattle is a first class Washington city and the largest city in the state. The City of Seattle and approximately 41 other cities impose a business and occupation tax that is similar to the tax imposed by the State of Washington at issue in this case. *See* Seattle Municipal Code ("SMC") 5.45.050; RCW 35.102.030-040. Under RCW 35.102.040(2), any Washington City that desires to impose a B&O tax is required to adopt certain mandatory provisions of a model B&O tax ordinance drafted by a committee of cities. One of the mandatory provisions of the model ordinance is the definition of "gross income of the business" that is the same as stated in 82.04.080 and that is at issue in this case. RCW 35.102.040(2)(g). Thus, the court of appeals' interpretation of the definition of "gross income of the business" is relevant to the taxing authority of all Washington cities that impose a B&O tax. The court of appeals' decision could, contrary to the intent of the legislature, adversely affect Seattle and other cities that impose a B&O tax.

III. ISSUES ADDRESSED BY AMICUS CURIAE

Can a taxpayer that purchases services from a third-party exclude the amount paid for those services from its gross income for B&O tax purposes?

IV. ARGUMENT

A. The Decision Below Involves An Issue of Substantial Public Interest That Should Be Determined By The Supreme Court Under RAP 13.4(b)(4).

The B&O tax makes up a substantial portion of the City of Seattle's budget. The City forecast B&O tax collections of $162.4 million for 2009, approximately 18% of the City's General Subfund revenues.[1] Statewide, according to the Washington State Auditor, in 2008 42 cities collected a total $287,149,602 in local B&O taxes.[2] The court of appeals' decision could adversely affect the ability of Seattle and other Washington cities to impose their B&O tax on companies like Washington Imaging Services that purchase services from a third party.

---

[1] *See* City of Seattle 2010 Adopted Budget, p. 25; available at: http://www.seattle.gov/financedepartment/10adoptedbudget/INTRODUCTION.pdf.

[2] Washington State Department of Revenue, Tax Reference Manual, Information on State and Local Taxes in Washington State, p. 125 (2010). Available at: http://dor.wa.gov/Content/AboutUs/StatisticsAndReports/2010/Tax_Reference_2010/default.aspx.

In addition to lost future revenues, these cities could face refund requests going back to 2006 by other companies that had business arrangements similar to Washington Imaging Services ("WIS").

The legislature did not intend to permit taxpayers to reduce their gross income by deducting the cost of services purchased from a third party. The definition of gross income of the business specifically prohibits a taxpayer from deducting its business expenses:

> "Gross income of the business" means the value proceeding or accruing by reason of the transaction of the business activity engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes or any other expense whatsoever paid or accrued and without any deduction on account of losses.

SMC 5.30.035(D) (emphasis added). The court of appeals permitted Washington Imaging Services to deduct the cost of obtaining a professional medical interpretation of images taken by WIS. Such deductions are specifically prohibited under state and city tax codes.

Accordingly, this case presents a matter of substantial public importance because it will result in lost revenue and tax refunds requests

unless the Supreme Court accepts review under RAP 13.4(b)(4) and corrects the court of appeals' decision.

B. The Supreme Court Should Accept Review Under RAP 13.4(b)(1) Because The Decision Below Conflicts With Decisions Of The Supreme Court.

The court of appeals failed to follow Supreme Court decisions that have interpreted the definition of gross income to prevent taxpayers from deducting business expenses from their gross income. Under RAP 13.4(b)(1), this is grounds for review by the Supreme Court.

The Washington Supreme Court addressed pass-through payments in *Christensen, O'Connor, Garrison & Havelka v. Department of Revenue*, 97 Wash.2d 764, 769, 649 P.2d 839 (1982). The Court held that a taxpayer may exclude pass-through payments when the following three conditions are met: (1) The payments are customary reimbursements or advances made by the taxpayer to procure a service for the client; (2) the payments involve services that the taxpayer did not or could not render; and (3) the taxpayer is not liable for paying, except as the agent of the client. *Id.* at 768-769.[3]

---

[3] The City of Seattle does not currently have a rule equivalent to WAC 458-20-111. But the City has incorporated similar provisions into its code in SMC 5.45.040C. Under that section, a taxpayer can make such a "pass-through" deduction only if it is acting as an agent for its client and is not liable to pay for the services itself. SMC 5.45.040C states:

> C. Services in Own Name -- Procuring Services as Agent. For purposes of this subsection, SMC Section 5.45.040C, an agent is a person who acts under the

Similarly, the court addressed this situation in *City of Tacoma v. William Rogers Co.*, 148 Wn.2d 169, 60 P.3d 79 (2002). In *William Rogers*, the court refused to find that payments received by a temporary staffing service were pass-through payments. The court explained:

> Because the B&O tax is based on gross income, no deduction is permitted for expenses involved in conducting a business. However, because amounts that merely "pass through" a business in its capacity as an agent cannot be attributed to the business activities of the agent, such amounts are not taxable.

William Rogers, 148 Wn.2d at 175 (emphasis added). The court held that "the taxpayer had to prove that the advance in question was made pursuant to an agency relationship." *Id.* at 177.

---

direction and control of the principal in procuring services on behalf of the principal that the person could not itself render or supply. Amounts received by an agent for the account of its principal as advances or reimbursements are exempted from the measure of the tax only when the agent is not primarily or secondarily liable to pay for the services procured.

Any person who claims to be acting merely as agent in obtaining services for a principal will have such claim recognized only when the contract or agreement between such persons clearly establishes the relationship of principal and agent and when the following conditions are complied with:

1. The books and records of the agent show that the services were obtained in the name and for the account of the principal, and show the actual principal for whom the purchase was made; and

2. The books and records show the amount of the service that was obtained for the principal, the amount of commissions and any other income derived by the agent for acting as such. Amounts received from the principal as advances and reimbursements must not be reflected as the agent's income on any of the agent's books and records. Commissions must be computed according to a set percentage or amount, which is agreed upon in the agency agreement.

Once the taxpayer establishes the existence of an agency relationship with its clients, then, "a second question must be asked: whether the taxpayer's liability to pay the advance "constituted *solely* agent liability." *Id.* at 178. The court in *William Rogers* held that the taxpayer failed to show that it acted as an agent or that it acted "solely as the agent of its clients for the purpose of" making the payments. *Id.* The court found that the taxpayer did not pay the temporary workers pursuant to an agency relationship. *Id.*

In this case, WIS's clients contracted for WIS's services. CP 141. WIS's clients' only legal obligation is to WIS. The clients have no separate legal obligation to Overlake. Although Overlake's contract with WIS makes WIS's obligation contingent on WIS receiving payment, WIS's clients have no direct obligation to pay Overlake. That is because the payments to Overlake are simply payments for services that WIS uses to provide a product to its clients. WIS purchases Overlake's interpretations of WIS's images and uses those interpretations to prepare written reports for its clients . *Washington Imaging Services,* 153 Wn. App. at 290. The payments to Overlake are simply a business expense to Overlake. The payments from WIS's clients are not advances or reimbursements because the clients are not liable to Overlake for those

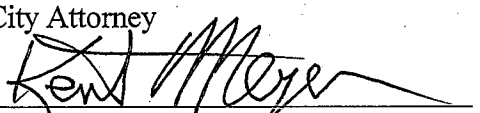
payments. The court of appeals incorrectly allowed WIS to deduct payments to Overlake from its gross income.

V. CONCLUSION

The Court should grant the Department of Revenue's petition for review. This case presents issues of substantial public interest because Washington cities rely on the B&O tax as a significant source of revenue. Under RCW 35102.040, cities rely on the same definition of gross income as the State. The court of appeals' decision conflicts with earlier decisions of this Court and the court of appeals. Consequently, this Court should accept review to correct the decision below.

DATED this 15 day of March, 2010.

PETER S. HOLMES
Seattle City Attorney

By: 
Kent C. Meyer, WSBA #17245
Attorneys for City of Seattle

CERTIFICATE OF SERVICE

I, certify that on this date I caused a copy of Amicus Brief of the City of Seattle to be filed with the court and served legal messenger on:

Greg Montgomery
Miller Nash LLP
4400 Two Union Square
601 Union Street
Seattle, WA 98101-2352

Peter B. Gonick
Heidi A. Irvin
Attorney General's Office – Revenue Division
7141 Cleanwater Dr. SW
P.O. Box 40123
Olympia, WA 98504-0123

Signed at Seattle, Washington, this 15th day of March, 2010.

Patricia Albert